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In the Supreme Court of the United States

OCTOBER TERM, 1991

UNITED STATES DEPARTMENT OF THE TREASURY AND
MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,
PETITIONERS

v.

GEORGE FABE, SUPERINTENDENT OF INSURANCE,
STATE OF OHIO

**PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT**

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QUESTION PRESENTED

The federal priority statute, 31 U.S.C. 3713(a) (1) (A), requires that a debtor's obligations to the United States be given first priority in state insolvency proceedings. An Ohio statute provides that claims of the United States are entitled to fifth priority in proceedings to liquidate an insolvent insurance company. The federal priority statute preempts the state priority statute unless the state statute is subject to the anti-preemption provisions of the McCarran-Ferguson Act, 15 U.S.C. 1012. Accordingly, the question presented is:

Whether a state statute establishing the priority of creditors' claims in a proceeding to liquidate an insolvent insurance company is a law regulating "the business of insurance" within the meaning of the McCarran-Ferguson Act.

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PETITION FOR A WRIT OF CERTIORARI
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FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of the United States Department of the Treasury, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-30a) is reported at 939 F.2d 341. The opinion of the district court (App., *infra*, 31a-49a) is unreported.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 50a-51a) was entered on July 17, 1991. A petition for rehearing was denied on November 21, 1991.

App., *infra*, 52a-53a. On February 10, 1992, Justice Stevens extended the time for filing a petition for a writ of certiorari to and including March 20, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

The federal priority statute, 31 U.S.C. 3713 (a) (1) (A), provides, in part:

A claim of the United States shall be paid first when—

(A) a person indebted to the Government is insolvent and—

(i) the debtor without enough property to pay all debts makes a voluntary assignment of property;

(ii) property of the debtor, if absent, is attached; or

(iii) an act of bankruptcy is committed.

The McCarran-Ferguson Act, 15 U.S.C. 1012, provides, in part:

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to the business of insurance.

STATEMENT

1. In 1986, an Ohio court declared American Druggists' Insurance Company (ADIC) insolvent. The court ordered that ADIC be liquidated and ap-

pointed respondent to serve as liquidator. The United States filed claims in excess of \$10.7 million in the liquidation proceeding on immigration, appearance, performance, and payment bonds issued by ADIC as surety. The United States asserted first priority for its claims on the basis of the federal priority statute, 31 U.S.C. 3713(a) (1) (A). App., *infra*, 2a.

Respondent brought a declaratory judgment action in federal district court seeking to establish that the federal priority statute does not preempt an Ohio statute establishing the priority of the claims in insurance liquidation proceedings. Under the Ohio statute, claims of federal, state, and local governments are entitled to fifth priority, ranking behind (1) administrative expenses, (2) wage and benefit claims, (3) policyholders' claims, and (4) claims of general creditors. See Ohio Rev. Code Ann. § 3903.42 (Anderson 1989). Respondent argued that the Ohio priority statute, rather than the federal priority statute, governs the claims of the United States because of the anti-preemption provisions of the McCarran-Ferguson Act. App., *infra*, 2a-3a.

The district court entered summary judgment for the United States. App., *infra*, 31a-49a. The court concluded that a state statute establishing the priority of claims against an insolvent insurance company does not regulate the "business of insurance" within the meaning of the McCarran-Ferguson Act. Accordingly, the court held that the federal priority statute governs the priority of the federal claims.¹

¹ The district court also held that claims of laborers, materialmen, and subcontractors suing on payment bonds under the Miller Act, 40 U.S.C. 270b, are not claims of the United States for purposes of the federal insolvency statute. See App., *infra*, 45a-48a. The government did not appeal from that ruling.

2. The court of appeals reversed. App., *infra*, 1a-30a. The court applied the three-part test for determining whether a practice is part of the business of insurance:

[F]irst, whether the practice has the effect of transferring or spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry.

App., *infra*, 9a (quoting *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982)). The court of appeals recognized that the two other courts of appeals that have decided the question "[b]oth rejected the argument that * * * liquidation priority statutes * * * regulate[] the 'business of insurance.'" App., *infra*, 15a (citing *Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988), cert. denied, 490 U.S. 1065 (1989); *Gordon v. United States Dep't of the Treasury*, 846 F.2d 272 (4th Cir.), cert. denied, 488 U.S. 954 (1988)). The court nevertheless held that the Ohio priority statute regulates the business of insurance because it "is a state regulation which protects the interests of the insured." App., *infra*, 20a.

The court held that the Ohio priority statute meets all three parts of the *Pireno* test. First, the court of appeals concluded that the Ohio statute has the effect of transferring and spreading the policyholder's risk that the insurer will become insolvent. App., *infra*, 21a-22a. Second, the court concluded that the priority statute is an integral part of the relationship between the insurer and the insured because it is designed to protect that relationship by providing as-

surances as to the reliability of insurance policies. *Id.* at 22a. Finally, although the court recognized that not all creditors of an insolvent insurance company are policyholders, it concluded that the third prong of *Pireno* was satisfied because the "focus" of the statute is on the protection of policyholders. *Id.* at 23a.

Judge Edgar concurred separately. App., *infra*, 23a-25a. He observed that, in enacting the McCarran-Ferguson Act, Congress intended "to restore the law to its status prior to [*United States v. Southeastern Underwriters [Ass'n]*, 322 U.S. 533 (1944)]." App., *infra*, 24a. Judge Edgar concluded that the McCarran-Ferguson Act did not modify the "long standing, traditional state regulation of insurance company liquidations." *Ibid.*

Judge Jones dissented. App., *infra*, 25a-30a. As to the first *Pireno* factor, he concluded that the risk of insurer insolvency is "qualitatively distinct from the risk the policyholder seeks to transfer in an insurance contract," App., *infra*, 27a (quoting *Gordon*, 846 F.2d at 273), and rejected the majority's conclusion that the priority statute involves risk transfer and risk spreading. Judge Jones found that the majority's view was contradicted by this Court's conclusion in *Pireno* that "[t]he transfer of risk from insured to insurer is effected by means of the contract between the parties—the insurance policy—and that transfer is complete at the time that the contract is entered." App., *infra*, 27a (quoting 458 U.S. at 130). As to the second *Pireno* factor, Judge Jones concluded that the priority statute is not an integral part of the policy relationship. "Rather than playing an integral role in the policy relationship between insurer and insured," the Ohio priority statute instead "addresses 'the relationship between those left

in the lurch by the expiration of the insurer.' " App., *infra* (quoting *Soward*, 858 F.2d at 454). Finally, Judge Jones concluded that the third *Pireno* factor also supported preemption because the Ohio priority statute is not limited to entities within the insurance industry, but instead governs the rights of all creditors. App., *infra*, 30a.

REASONS FOR GRANTING THE PETITION

1. As the court of appeals recognized (App., *infra*, 15a), the decision in this case squarely conflicts with decisions of the two other courts of appeals that have decided the issue. See *Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988), cert. denied, 490 U.S. 1065 (1989); *Gordon v. United States Dep't of the Treasury*, 846 F.2d 272 (4th Cir.), cert. denied, 488 U.S. 954 (1988). In addition, the court of appeals' decision conflicts with the decisions of state courts. See *In re Union Indemnity*, 551 N.Y.S.2d 446 (Sup. Ct. 1990), aff'd *sub nom. Curiale v. United States*, 566 N.Y.S.2d 853 (App. Div. 1991), petition for cert. pending, No. 91-1347; *Langdeau v. United States*, 363 S.W.2d 327 (Tex. Civ. App. 1962). The issue has been thoroughly discussed in the three opinions in this case, as well as in the opinions of the other courts that have decided this question. The Sixth Circuit has declined to grant rehearing en banc. App., *infra*, 54a-55a. Accordingly, the issue is ripe for review by this Court.

2. The question presented is an important one. Congress enacted a federal priority statute in the earliest days of the national government, see Act of Mar. 3, 1797, ch. 210, § 5, 1 Stat. 512, 515, to serve the important purpose of "secur[ing] an adequate revenue to sustain the public burdens, and discharge

the public debts." *United States v. State Bank of North Carolina*, 31 U.S. (6 Pet.) 29, 35 (1832). See *United States v. Moore*, 423 U.S. 77, 82 (1975); *King v. United States*, 379 U.S. 329 (1964).

The Ohio priority statute, like similar priority statutes enacted by other States, ranks claims of the United States behind several other classes of claims.² Under these statutes, the United States will often recover little or nothing on its claims against insolvent insurers. The effect on the federal revenue is significant. Nearly \$11 million is at stake in this case alone. The issue has assumed even greater practical significance as the rate of insurance company insolvencies has increased. See generally Staff of House Comm. on Energy and Finance, 101st Cong., 2d Sess., *Failed Promises: Insurance Company Insolvencies 2* (Comm. Print 1990) (noting that nearly half of 150 property-casualty insurance company insolvencies since 1969 occurred within the last five years, and that insurance company assessments to cover the costs of insolvencies amounted to \$900 million in 1987, nearly half the total assessments of \$2.2 billion for the period from 1969 to 1987).

3. The court of appeals' conclusion that the McCarran-Ferguson Act permits state governments to deny the United States the first priority otherwise mandated by 31 U.S.C. 3713(a) in insurance company insolvency proceedings conflicts with this Court's precedents. State statutes governing the liquidation of insurance companies come into play

² The state priority statutes at issue in *Gordon* and *Soward* provide additional examples. See Md. Ann. Code art. 48A, §§ 158-158A (1986) (assigning fourth priority to claims of the United States as policyholder); Idaho Code § 41-3342 (1990) (assigning fifth priority to claims of the United States).

only when an insurance company's business has failed and the company is being liquidated. As such, those statutes are specialized bankruptcy laws. They are not laws regulating the "business of insurance" within the meaning of the McCarran-Ferguson Act.

The Court has recognized that much of the business of insurers is not the "business of insurance." *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 211 (1979) (price agreements between insurer and pharmacies are not the business of insurance). See also *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982) (use of peer review committee to determine whether charges are covered by insurance policy is not the business of insurance); *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969) (regulation of the relationship between the insurance company and its stockholders is not the business of insurance). The Ohio priority statute fails the three-part test established by this Court for determining whether a statute regulates the business of insurance.³

a. The Ohio priority statute does not have the effect of transferring and spreading a policyholder's risk. The Court has explained that "[t]he primary elements of an insurance contract are the spreading and underwriting of a policyholder's risk. * * * [T]he concept of 'insurance' involves some investment risk-taking on the part of the company." *Royal Drug*, 440 U.S. at 211-212 (quoting *SEC v. Variable*

³ As the court of appeals recognized (Pet. App. 11a), the *Pireno* test is not limited to cases involving the antitrust laws. See *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41 (1987) (ERISA); *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724 (1985) (ERISA); *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969) (securities laws); *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959) (securities laws).

Annuity Life Ins. Co., 359 U.S. 65, 71 (1959)). In *Pireno*, the Court further explained that "[t]he transfer of risk from insured to insurer is effected by means of the contract between the parties—the insurance policy—and that transfer is complete at the time that the contract is entered." 458 U.S. at 130.

In this case, the risk of insurer insolvency is not one of the risks covered by the insurance policy. In addition, the covered risk is transferred when the insurance contract is executed, not when the insured submits a claim. And the priority statute does not result in any underwriting or investment risk-taking by the insurance company. Thus, the Ohio statute is "logically and temporally unconnected to the transfer of risk accomplished by [the] insurance polic[y]." *Pireno*, 458 U.S. at 130.

To be sure, the Ohio statute affects the risk that a policyholder's future claims will be paid in the event the insurance company becomes insolvent. But virtually all government regulation of insurance companies has some impact on a policyholder's risk of nonpayment. For example, regulation of the cost-cutting measures at issue in *Royal Drug*, and the peer review system at issue in *Pireno*, affected insurer costs, and therefore the risk that the insurer would be unable to pay claims. As the Court noted in *Royal Drug*, "[m]any aspects of insurance companies are regulated by state law, but are not the 'business of insurance.'" 440 U.S. at 230 n.38 (citing as examples "how [insurance companies] could invest their funds, when they could liquidate or merge, as well as how they could purchase goods and services") (emphasis added).

b. Nor is the Ohio priority statute integral to the contractual relationship between the insurance com-

pany and the insured. The Ohio statute is obviously distinct from the contract of insurance itself. Moreover, the Ohio statute does not address the relationship between the insurance company and the insured, but rather the relationship between policyholders and other creditors of insolvent insurance companies. Accordingly, the Ohio statute is properly viewed as one of many state laws applicable to insurance companies that are not integral to the contractual relationship even though the law may affect the probability that future policyholder claims will be paid.

c. Finally, the Ohio priority statute plainly is not limited to entities in the insurance industry. As the court of appeals recognized (App., *infra*, 23a), the Ohio statute applies to *all* creditors of insolvent insurance companies, including general business creditors, employees, and the government. The court of appeals nevertheless concluded that the statute is limited to entities in the insurance industry because it “focus[es]” on the protection of policyholders. In fact, the Ohio statute does not focus exclusively on the protection of policyholders, since it ranks two classes of claims (administrative expenses and wages) ahead of policyholder claims. In any event, the relevant question is not whether the statute “focus[es]” on policyholders, but whether it is part of the “business of insurance.” For the reasons set out above, it is not.

4. The court of appeals’ decision is also inconsistent with the purpose and legislative history of the McCarran-Ferguson Act. Congress passed the Act in 1945 in response to *United States v. South-Eastern Underwriters Ass’n*, 322 U.S. 533 (1944), which held that insurance transactions are subject to federal regulation under the Commerce Clause. The Act was “an attempt to turn back the clock” to pre-*South-Eastern*

Underwriters days. *National Securities*, 393 U.S. at 459. In *United States v. Knott*, 298 U.S. 544 (1936), a pre-McCarran Act case, the Court held that the federal insolvency statute applied in state court proceedings to liquidate an insolvent insurance company and preempted a state statute that provided for repayment of in-state creditors ahead of all other creditors. Nothing in the language or legislative history of the McCarran-Ferguson Act suggests that Congress intended to alter that result.

More generally, “[t]he primary concern of Congress in the wake of [*South-Eastern Underwriters*] was in enacting legislation that would ensure that the States would continue to have the ability to tax and regulate the business of insurance.” *Royal Drug*, 440 U.S. at 217-218. As the Court explained, “[t]he problem was that if insurance was interstate commerce, then the constitutionality of state regulation and taxation would be questionable.” *Id.* at 218 n.16 (citing S. Rep. No. 20, 79th Cong., 1st Sess. 2 (1945); H.R. Rep. No. 143, 79th Cong., 1st Sess. (1945)). Here, there is no danger that Ohio will be unable to regulate the liquidation of insolvent insurance companies. The question is simply whether the federal priority statute preempts the state priority statute as to claims of the United States.⁴

⁴ “A secondary concern” of Congress in enacting the McCarran-Ferguson Act “was the applicability of the antitrust laws to the insurance industry.” *Royal Drug*, 440 U.S. at 218. The antitrust exemption was directed primarily at cooperative ratemaking “[b]ecause of the widespread view that it is very difficult to underwrite risks in an informed and responsible way without intra-industry cooperation.” *Id.* at 221. See also *Pireno*, 458 U.S. at 133. Neither the antitrust laws nor cooperative ratemaking are at issue here.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 90-3364

GEORGE FABE, Superintendent of Insurance,
State of Ohio, PLAINTIFF-APPELLANT

v.

UNITED STATES DEPARTMENT OF THE TREASURY;
MITCHELL A. LEVINE, Assistant Commissioner,
DEFENDANTS-APPELLEES

On Appeal from the United States District Court
for the Southern District of Ohio

Decided and Filed July 17, 1991

Before: MARTIN and JONES, Circuit Judges;
and EDGAR, District Judge.*

BOYCE F. MARTIN JR., Circuit Judge. In this declaratory judgment action, the district court found that certain claims of the United States against an insolvent Ohio insurance company are entitled to priority as provided by 31 U.S.C. § 3713 (1988), notwithstanding contrary provisions of Ohio law. Be-

* The Honorable R. Allen Edgar, United States District Judge for the Eastern District of Tennessee, sitting by designation.

cause we find the Ohio insurance liquidation priority scheme at issue to be a regulation of the "business of insurance" within the meaning of the McCarran-Ferguson Act, 15 U.S.C. § 1012(b) (1988), and thus subject solely to the provisions of state law absent explicitly conflicting federal legislation, we reverse.

The facts of this case are uncontested. On April 30, 1986, the Court of Common Pleas for Franklin County, Ohio declared the American Druggists' Insurance Company insolvent. Pursuant to Ohio Rev. Code § 3903, the court directed that American Druggists' be liquidated and appointed George Fabe, the Superintendent of Insurance for the State of Ohio, to serve as liquidator.

The United States filed claims in the liquidation proceedings as obligee on various immigration, appearance, performance and payment bonds issued by American Druggists' as surety. The United States notified Fabe on August 28, 1986, that it would seek first priority for its claims by virtue of the federal superpriority statute, 31 U.S.C. § 3713(a)(1)(A).¹ Thereafter, Fabe filed for a declaratory judgment in federal district court arguing that the federal superpriority statute does not apply to Ohio's liquidation

¹ 31 U.S.C. § 3713 provides, in pertinent part:

(a) (1) A claim of the United States shall be paid first when-

(A) a person indebted to the Government is insolvent and-

- (i) a debtor without enough property to pay all debts makes a voluntary assignment of property;
- (ii) property of the debtor, if absent, is attached; or
- (iii) an act of bankruptcy is committed[.]

of American Druggists' because the controlling state priority statute, Ohio Rev. Code § 3903.42, is a regulation of the "business of insurance" within the meaning of the McCarran-Ferguson Act. Accordingly, Fabe argues that § 3903.42 takes precedence over the federal statute, entitling the United States to the lesser priority afforded by state law.

Before the district court, both parties stipulated that Ohio Rev. Code § 3903.42 is a state law which regulates the insurance industry, that application of the federal priority statute would "invalidate, impair, or supercede" the state statute, and that the federal priority statute is not an act which specifically relates to the "business of insurance." See McCarran-Ferguson Act, 15 U.S.C. § 1012(b). Therefore, the sole issue presented to both the district court and this court on appeal is whether the Ohio insurance liquidation priority statute is a state law regulating the "business of insurance" within the meaning of the McCarran-Ferguson Act. After a thorough review of relevant precedent, the district court entered judgment for the United States, concluding that Ohio Rev. Code § 3903.42 regulates only the business of insurance companies, not the "business of insurance." See *Securities & Exchange Commission v. National Securities*, 393 U.S. 453, 460 (1969). As a pure question of law, we consider this issue on appellate review independent of the district court's decision. *Salve Regina College v. Russell*, 111 S. Ct. 1217 (1991).

Prior to 1944 the authority to regulate insurance transactions rested exclusively with the several states. *National Securities*, 393 U.S. at 458 (citing *Paul v. Virginia*, 75 U.S. (8 Wall) 168, 183 (1869) (insurance transactions not considered "commerce")). That relationship changed following the Supreme

Court's conclusion in *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), that insurance transactions are commerce, subject to federal regulation under the Commerce Clause. Because Congress feared injury to the traditional policy of state regulation of the insurance industry, it quickly responded.

Declaring that "the continued regulation and taxation by the several States of the business of insurance is in the public interest[.]" 59 Stat. 33, 15 U.S.C. § 1011, Congress passed the McCarran-Ferguson Act, 15 U.S.C. § 1012, to protect the dominion of the states over the "existing and future . . . systems for regulating and taxing the business of insurance." *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 429 (1946). The Act provides:

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance[.]²

15 U.S.C. § 1012. Although the Act exempts from federal preemption only those state regulations which concern the "business of insurance," neither the Act nor its legislative history is particularly enlightening

² Several congressional enactments, including the Sherman Act, Clayton Act, and Federal Trade Commission Act, have been amended pursuant to McCarran-Ferguson to provide for continuing federal dominance in areas of national concern. The federal superpriority statute has not been so amended.

as to the meaning of that term. *National Securities*, 393 U.S. at 459. Accordingly, we turn to the Supreme Court's trilogy of cases construing the "business of insurance" to determine whether that term encompasses the Ohio statute.

The first of these three cases interpreting the "business of insurance" under the McCarran-Ferguson Act is *Securities & Exchange Commission v. National Securities*, *id.* at 453. In *National Securities* the Court confronted the issue of whether the Securities & Exchange Commission had the power to regulate the activities of persons engaged in the insurance business. Specifically, the case focused on an Arizona insurance company which made a number of misrepresentations to shareholders in an attempt to secure their approval for a pending merger. The company sought to avoid prosecution for federal securities violations on the grounds that an Arizona statute aimed at protecting stockholders in domestic insurance companies regulated the "business of insurance," and thus superceded the federal securities act by operation of McCarran-Ferguson. The Supreme Court disagreed.

The Court determined that the Arizona statute was not protected from federal preemption by McCarran-Ferguson because the Act applied only to laws regulating the "business of insurance," not the business of insurance companies. *Id.* at 459. The Court stated:

Congress was concerned with the type of state regulation that centers around the contract of insurance, the transaction which *Paul v. Virginia* held was not "commerce." The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement—these were the core of

the "business of insurance." Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting this relationship, directly or indirectly, are laws regulating the "business of insurance."

Id. at 460. Because the Arizona statute regulated the relationship between shareholder and corporation, rather than insured and insurer, it "is not insurance regulation, but securities regulation[,] unprotected by McCarran-Ferguson. *Id.* That the Arizona statute applied exclusively to insurance companies is irrelevant:

The crucial point is that here the State has focused its attention on stockholder protection; it is not attempting to secure the interests of those purchasing insurance policies. Such regulation is not within the scope of the McCarran-Ferguson Act.

Id.

The Court was next called upon to construe the meaning of "business of insurance" in *Group Life & Health Insurance Company v. Royal Drug Company*, 440 U.S. 205 (1979). In *Royal Drug* the Court considered whether alleged anticompetitive agreements between an insurance company and several pharmacies were exempt from the federal antitrust laws. Group Life had entered into agreements with certain pharmacies under which those pharmacies agreed to furnish the insurer's policyholders with prescription

drugs at the price of two dollars per prescription, while Group Life agreed to reimburse the participating pharmacies for their costs in acquiring the prescription drugs sold. Other non-participating pharmacies sued claiming that such agreements violated the Sherman Antitrust Act by fixing the retail price of drugs and by deterring policyholders from dealing with independent retailers. Group Life argued that the agreements were exempt from the antitrust laws as the "business of insurance" regulated by Texas law. Again the Supreme Court disagreed.

The Court began its analysis by noting that central to the definition of the "business of insurance" are "the spreading and underwriting of a policyholder's risk . . . [and] the contract between the insurer and the insured." *Id.* at 211, 215. It found the provider agreements at issue served neither goal. The agreements acted simply as separate contractual arrangements for the purchase of goods and services between the insurer and a third party which furnished the insurer with a substantial cost savings. *Id.* at 216. They did not, as Group Life argued, affect the "'reliability, interpretation, and enforcement' of the insurance contract [or] 'relate so closely to their status as reliable insurers' as to fall within the exempted area." *Id.* To equate cost effectiveness with reliability would be to distort the notion of the "business of insurance" to such a degree that any business decision made by an insurance company to maximize profits and minimize costs would qualify for exemption.

The Court concluded by suggesting that the provider agreements were not made the business of insurance simply because they were subject to state regula-

tion at the time McCarran-Ferguson was enacted. *Id.* at 230 n. 38.

[T]he enabling statutes in existence at the time the Act was enacted typically regulated such diverse aspects of the plans as the composition of their boards of directors, when their books and records could be inspected, how they could invest their funds, *when they could liquidate* or merge, as well as how they could purchase goods and services by entering into provider agreements.

Provider agreements are no more the "business of insurance" because they were regulated by state law at the time of the McCarran-Ferguson Act than are these other facets of the plans which were similarly regulated.

Id. (emphasis added). Accordingly, the Court found the purpose of McCarran-Ferguson was not to restore the law to the status quo prior to *South-Eastern*, but to protect state regulation only of the "business of insurance." *Id.* at 230.

The Court's most recent opinion concerning the "business of insurance" is *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). Pireno was a chiropractic practitioner who challenged Union Labor Life's use of a chiropractic peer review committee to make non-binding recommendations as to whether policyholder claims were "reasonable charges" for "necessary medical care and services," and therefore payable within the coverage limits of the insureds' policies. *Id.* at 122. Pireno's methods were criticized by the committee which recommended that Union Labor Life not pay claims arising from his treatment because both the number of prescribed visits and the cost per treatment were excessive. Pireno sued

claiming Union Labor Life's use of the peer review committee was a conspiracy to fix prices and restrain competition in violation of the Sherman Act. The district court granted summary judgment to Union Labor Life on the grounds that use of the peer review committee provided an efficient means of determining the company's obligation in the claims adjustment process, and so was protected from antitrust scrutiny by the McCarran-Ferguson Act. Again, the Supreme Court disagreed.

The Court reviewed its prior decisions and identified a three-part test for determining whether certain conduct is part of the "business of insurance."

[F]irst, whether the practice has the effect of transferring or spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry. None of these criteria is necessarily determinate in itself. . . .

Id. at 129. Applying this test, the Court found the agreement between Union Labor Life and the peer review committee to fail each of the three prongs.

The Court first rejected Union Labor Life's argument that the peer review activity was within the "business of insurance" because it aided the insurer in determining the scope of the risk transferred. The Court found the foundation of this argument, that risks were transferred upon payment, to be contrary to the fundamental tenets of insurance: "The transfer of risk from insured to insurer is effected by means of the contract between the parties-the insurance policy-and that transfer is complete at the time that

contract is entered." *Id.* at 130; *See* 9 G. Couch, *Cyclopedia of Insurance Law* §§ 39.53; 39:63 (2d ed. 1962). Though the Court did find the actual claims adjustment process to be within the "business of insurance," the non-binding nature of the committee's recommendations removed it so far from the policy relationship that it could not be said to be central to the risks spread at the time of contracting. *Id.* at 134 n.8.

In addressing the second criterion, the Court found it clear that the peer review system was not "an integral part of the policy relationship between insurer and insured." *Id.* at 131. Like the provider agreements at issue in *Royal Drug*, the arrangement between Union Labor Life and the peer review committee was a separate and distinct contract between the insurer and a third party non-insurer, with only ancillary impact upon the contract of insurance. Such arrangements are not the "business of insurance," but merely cost savings devices which are immaterial to the policyholder whose only concern is that his claim be paid, not why it is paid. *Id.* at 132.

The Court also had little difficulty finding that the challenged peer review activities were not "limited to entities within the insurance industry," because the very nature of the agreement at issue implicated the substantial and direct involvement of third party non-insurers. *Id.* Though "the challenged peer review practices need not be denied the [McCarran-Ferguson] § 2(b) exemption solely because they involve parties outside the insurance industry[,]" it is clear that such third party arrangements which have only an ancillary effect on policy holders were not at the core of Congressional concern during the passage of the McCarran-Ferguson Act. *Id.* at 133. Accord-

ingly, the peer review agreements are subject to the provisions of the Sherman Act, because they do not regulate the "business of insurance."

Though *Pireno* is the latest case addressing the meaning of the "business of insurance," its analysis is but a distillation of the earlier cases. We disagree with Fabe's assertion here that *Pireno* and *Royal Drug* are limited to antitrust exemption; given the Supreme Court's use of the *Pireno* analysis in other contexts, we find that argument to be untenable. *See Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 742-44 (1985) (applying *Pireno* test to define "business of insurance" under ERISA savings clause); *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 50-51 (1987) (same). Rather, we find *National Securities* and *Royal Drug* to be of continuing instructive value in the application of *Pireno*. Accordingly, our review of Ohio Rev. Code § 3903.42 will draw from each of these opinions.

The state regulation at issue in this case, Ohio Rev. Code § 3903.42, is part and parcel of a large, complex and specialized administrative system adopted by the State of Ohio to regulate the life of domestic insurance companies from incorporation to dissolution pursuant to McCarran-Ferguson. Ohio Rev. Code § 3901 *et seq.* Chapter 3903 provides a comprehensive scheme for the orderly supervision, rehabilitation, and/or liquidation of Ohio insurance companies. *American Centennial Insurance Corp. v. ARMCO, Inc.*, 746 F. Supp. 350 (S.D.N.Y. 1990). Such regulation is critical to the protection of the insurance consumer because insurance companies are not subject to subrogation in bankruptcy proceedings under chapters seven or eleven of the Federal Bankruptcy Code. 11 U.S.C. § 109 (1979). For this reason, fed-

eral courts have often abstained from considering questions regarding state liquidation proceedings in order to protect the state's substantial interests in this regard. *See, e.g., Grimes v. Crown Life Ins. Co.*, 857 F.2d 699 (10th Cir. 1988), *cert. denied*, 489 U.S. 1096 (1989); *United Services Auto Ass'n v. Muir*, 792 F.2d 356 (3d Cir. 1986), *cert. denied sub nom. Grode v. United Services Auto. Ass'n*, 479 U.S. 1031 (1987); *Levy v. Lewis*, 635 F.2d 960 (2d Cir. 1980); *Washburn v. Corcoran*, 643 F. Supp. 554 (S.D.N.Y. 1986). Of course, abstention is inappropriate in this case which presents a direct federal question.

The stated purpose of Chapter 3903 is to provide a coherent policy for the liquidation of insurers for "the protection of the interests of insureds, creditors, and the public generally. . . ." Ohio Rev. Code § 3903.02(D). The district court provided an adequate synopsis of its pertinent provisions:

The Superintendent of Insurance may file a complaint seeking an order to liquidate an insurer for one of a number of reasons, Ohio Rev. Code § 3903.17, and if the Court of Common Pleas issues an order to liquidate[,] the superintendent is appointed as liquidator and is directed to liquidate the company. Ohio Rev. Code § 3903.18 (A). Within such liquidation Ohio Rev. Code § 3903.43 establishes the priorities for payment of claims.

Under § 3903.42, all claims against the liquidated insurance company are placed into classes and prioritized. All claims in each class are to be paid in full before members of subordinate classes may receive any payment. Classes one and two contain the usual provisions for the costs and expenses of administering

the scheme, and compensating employees for services performed and benefits accrued. Class three includes "all claims under policies for losses incurred," including policyholders who seek to recover their investments. Class four is limited to the claims of general creditors. Class five provides for any claims filed by federal, state, or local governments.

In the present case, American Druggists' was liquidated pursuant to the Ohio scheme. The United States filed claims in the insolvency proceedings as obligee on various general obligation surety bonds defaulted by American Druggists'. This case does not involve federal claims for taxes due, but merely federal claims against a defaulted surety in which the United States stands in the same position as other bond obligees. However, the United States asserts that, pursuant to the federal superpriority statute, it may leapfrog the claims of other policyholders solely because it is the United States. That argument turns on whether the Ohio liquidation priority statute regulates the "business of insurance."

Before turning our attention to those cases which have considered the issue of whether such priority schemes may be considered a regulation of the "business of insurance," we must address two arguments made by the United States which it argues are dispositive. The United States first contends that the issue before us was settled by the Supreme Court's 1936 opinion in *United States v. Knott*, 298 U.S. 544. It argues that because McCarran-Ferguson "was an attempt to turn back the clock," the Supreme Court's pre-McCarran holding in *Knott*, that a Florida insurance priority law was subject to federal preemption, controls the outcome of the case before us. We disagree with this assertion on two grounds. First,

McCarran-Ferguson did not return to the *status quo* prior to *South-Eastern Underwriters*; instead, it only permitted state regulation of the "business of insurance," without federal interference. *Royal Drug*, 440 U.S. at 220 n. 24. Second, even if it had, the Florida statute at issue in *Knott* contained only generalized provisions protecting domestic creditors in Florida insurance companies over foreign creditors; it in no way regulated the "business of the insurance" for the protection of the insured. See *National Securities*, 393 U.S. at 460 (where focus is away from the protection of insureds statute does not regulate the "business of insurance").

The United States' second conclusory argument is that footnote 38 of *Royal Drug*, 440 U.S. at 230, forecloses plaintiff's claim by listing among those statutes that do not regulate the business of insurance rules that concern *when* insurance companies may liquidate. We cannot agree with the implicit foundation of this argument, that any regulation of insurance liquidation is *per se* not a regulation of the "business of insurance." Rather, we find the better approach to be an independent assessment as to whether each facet of a challenged plan regulates the "business of insurance" under the *Pireno/Royal Drug/National Securities* trilogy.

As the parties have stipulated, it is beyond doubt that the provisions of the federal superpriority statute, 31 U.S.C. § 3713, are in direct conflict with Ohio Rev. Code § 3903.42. However, because the federal statute does not explicitly supercede McCarran-Ferguson, the state statute controls unless it was not enacted for the purpose of regulating the "business of insurance." Those courts that have considered whether an insurance liquidation priority statute may be considered a regulation of the "business of insurance" are split.

Only two federal circuit courts have addressed the precise question raised in this appeal, *State of Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988, *cert. denied sub nom. Fagiano v. United States*, 109 S. Ct. 2063 (1989) and *Gordon v. United States Dep't of the Treasury*, 668 F. Supp. 483 (D. Md. 1987), *aff'd*, 846 F.2d 272 (4th Cir.), *cert. denied*, 109 S. Ct. 390 (1988). Both rejected the argument that the liquidation priority statutes before them regulated the "business of insurance," though on divergent grounds. Other courts have considered the issue as an ancillary matter and have come to a different conclusion. *Grimes*, 857 F.2d at 704; *Muir*, 792 F.2d at 364; *Levy*, 635 F.2d at 965; *Washburn*, 643 F. Supp. at 556. Because each case makes fundamental assumptions as to the nature of the "business of insurance" within the *Pireno/Royal Drug/National Securities* line of cases, we shall review the major decisions to facilitate our analysis.

The first case to squarely address the issue, *Gordon v. United States Dep't of the Treasury*, 846 F.2d at 272, demonstrates some of the controversies surrounding the *Pireno* analysis. *Gordon* involved a Maryland insurance liquidation priority statute which placed government claims at the same level with those of policyholders. *Gordon*, 668 F. Supp. at 486. The United States asserted priority status in the liquidation proceedings of a Maryland insurer under 31 U.S.C. § 3713. As State Superintendent of Insurance, *Gordon* sued claiming that giving priority to federal claims would invalidate a state law regulating the "business of insurance" in violation of McCarran-Ferguson.

The Maryland district court's opinion, which was adopted by the Fourth Circuit, applied the *Pireno*

analysis and found McCarran-Ferguson inapplicable to the Maryland statute. The court rejected the abstention cases proffered by the Maryland Insurance Commission as authority that such statutes do regulate the "business of insurance" because none had applied the *Pireno* test. *Id.* at 489 n. 8. Stating, "[t]he risk that an insurance company will become insolvent . . . is not the type of risk transfer emphasized in *Pireno* and *Royal Drug*[,] the court found the liquidation statute failed the first prong of the *Pireno* test, whether the challenged statute facilitates the transfer or spread of risk. More importantly, the court stated that summary judgment for the United States could be made on this basis alone because the first prong is "indispensable,"³ *id.* at 490-91; although the court concluded by stating with little elaboration that neither of the other *Pireno* prongs were satisfied.

The Ninth Circuit addressed the question before us in *State of Idaho Ex Rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988). *Soward* involved an Idaho liquidation priority statute, Idaho Code § 41-3342, which is nearly identical to Ohio Rev. Code § 3903.42. The Director of the Department of Insurance for the State of Idaho sought judgment declaring that the state liquidation scheme prevailed over the federal superpriority statute because it was a regulation of the "business of insurance" under McCarran-Ferguson.

The Idaho district court agreed. *Soward*, 662 F. Supp. 60 (1987). The court found the liquidation priority scheme to be part of a larger administrative

³ The Fourth Circuit refused to consider the propriety of the district court's characterization of prong one as "indispensable." 846 F.2d at 274.

system for regulating of the entire life of domestic insurance companies. Relying on the abstention case of *Washburn v. Corcoran*, 643 F. Supp. at 554 (laws concerning winding up of insurance companies regulates the "business of insurance"), the court concluded that laws providing for the rehabilitation, liquidation or dissolution of insurance companies are laws regulating the "business of insurance" exempt from federal legislation because, "[t]he right of the state to regulate and control the insurance company should include the right to manage its dissolution and liquidation as part of the overall regulatory scheme." *Soward*, 662 F. Supp. at 63. However, the district court did not apply the *Pireno* analysis.

On appeal, the Ninth Circuit reversed. *Soward*, 858 F.2d at 445. The court analyzed the liquidation priority statute under the *National Securities* definition of "business of insurance," stating

Although ostensibly appearing to speak to the precise issue raised here, neither *Royal Drug* nor *Pireno* are necessary to decide this case. Both cases are refinements of the seminal analysis of *National Securities* tailored to address activities of insurance companies that would implicate the antitrust laws in the absence of the McCarran-Ferguson Act.

Id. at 452. The court found that the Idaho statute did not affect "the type of policy which could be issued, its reliability, interpretation, and enforcement" or protect the "relationship [of insured and insurer], directly or indirectly," because the regulation applies only to companies that are no longer in the business of insurance. *Id.* at 452 (quoting *National Securities*, 393 U.S. at 460.) Therefore, the court concluded the only relationship regulated by Idaho is that of debtor

and creditor, a relationship that is not protected by McCarran-Ferguson.⁴ *Soward*, 858 at 452.

Although both the Fourth and Ninth Circuits have rejected the theory of Fabe's claim, he is not without authority for his position. A number of courts have abstained from exercising federal jurisdiction in cases involving state insurance liquidation priority schemes on McCarran-Ferguson grounds. *See, e.g., Grimes*, 857 F.2d at 699 (court abstains declaring receivership regulations are laws concerning the "business of insurance"); *Levy*, 635 F.2d at 960 (court abstains in case involving conflict between state insurance liquidation statute and ERISA); *Washburn*, 643 F. Supp. at 554 (court abstains in conflict between Federal Arbitration Act and New York law regulating the liquidation of domestic insurance companies). These courts have determined that federal intervention into the complex administrative schemes developed by the states for the winding up of defaulting insurance companies risks damaging the delicate balance struck by state legislatures, who, acting pursuant to federal policy, are attempting to regulate a portion of the business of insurance which necessarily involves the adjustment of thousands of claims by policyholders against domestic insurers. *Washburn*, 643 F. Supp. at 556.

Though most of the abstention cases cited by plaintiff are weakened by their failure to apply the *Pireno* analysis, we do find these cases to be persuasive as to whether state regulation of insurance company insolvency and rehabilitation constitutes the regulation of the "business of insurance" within the meaning of

⁴ In dicta the court indicated that if it were to apply the *Pireno* test the liquidation priority would fail on similar grounds.

the McCarran-Ferguson Act. One case, however, *United Services Auto. Ass'n v. Muir*, 792 F.2d at 365, does discuss the effect of the *Pireno* paradigm on insurance liquidation priority statutes. In *Muir*, a domestic insurer sought to enjoin the state insurance commission from revoking its license to sell insurance for its violation of a state regulation prohibiting mergers between insurers and financial institutions. *Id.* at 359-60. Relying on *Levy*, 635 F.2d at 960, the district court found that abstention was appropriate because the statute at issue was one regulating the "business of insurance" under McCarran-Ferguson, over which the states have exclusive control. *Id.* at 364.

The Third Circuit reversed. Applying *Pireno*, the court found abstention inappropriate because the anti-merger provision did not implicate the "business of insurance." However, the court distinguished its holding from those abstention cases involving insurance liquidation proceedings, which it felt met the *Pireno* standard.

The state regulations implicated in *Levy* concerned both the future coverage of policyholders and their relationship with a defunct insurer, and so were authorized under McCarran-Ferguson. . . . Unlike the regulations in *Levy*, the [merger] section is not concerned with transferring or spreading the policyholder's risk; [the merger section] has no integral connection to the relationship between the insured and insurer; and [the merger section involves groups that are] not entities within the insurance industry.

Id. at 364.

As our discussion has developed, we are confronted with a confusing mass of interpretations as to the

term "business of insurance" which leaves basic, fundamental questions unanswered. Our starting point is the recognition that "[i]n the absence of the type of comprehensive federal regulation over insurance accorded the banking, securities and commodities industries, and because of the exclusion of insurance companies from the operation of federal bankruptcy law, 11 U.S.C. § 109, the states have assumed the primary role in regulating insurance," under the provisions of the McCarran-Ferguson Act. *Lac D'Amiante du Quebec v. American Home Assurance Company*, 864 F.2d 1033, 1039 (3d Cir. 1988). Accordingly, states have adopted a variety of regulatory mechanisms.

[t]he emphasis [of which has] been placed simply upon protecting the little policy-holder who cannot tell when he is charged too much for his insurance; since he does not investigate his purchase too carefully nor could he determine if a given insurer has the capacity, i.e. the solvency, to perform in the future when the insured event occurs, the States have established regulatory bodies to secure that necessary measure of protection.

Richards, *Insurance*, at 39. Thus if we apply a test of logic, Ohio Rev. Code § 3903.42 is a state regulation which protects the interests of the insured, and therefore is protected from federal preemption as a law regulating the "business of insurance." Accordingly, the United States, as bond obligee, is not permitted to supercede the claims of superior creditors.

We find nothing in *Pireno* to suggest that its three part test should not be applied in the present case. Ohio Rev. Code § 3903.42 fulfills the *Pireno* require-

ments because it (1) transfers the policyholders risk of loss by insolvency at the time of contracting, (2) is an integral part of the relationship between insurer and insured, and (3) is exclusive in its operation to entities within the insurance industry.

Section 3903.42 has the effect of transferring and spreading a policy holder's risk that his insurer will become insolvent. By transferring that risk from the policyholder to the illiquid insurer or its appointed receiver and spreading that risk among all those policyholders and non-policyholders who are entitled to a statutorily specified priority, § 3903.42 meets the first prong of the *Pireno* analysis.

The United States argues that § 3903.42 does not spread or transfer a policyholder's risk at the time of contract, but merely provides a means of payment after the insured event occurs, and therefore is insufficient under *Pireno*, 458 U.S. at 130. We disagree. The provisions of § 3903.42 are exclusive in their operation and furnish a complete procedure for the protection of the rights of all parties involved, including policyholders with claims for covered losses, and policyholders who seek to recoup their investments. Ohio Rev. Code 3903.42(C). Accordingly, we find § 3903.42 is designed to support and undergird the entire contractual process between insurer and insured, as implicitly recognized by the parties, by transferring the risk of insolvency immediately upon contacting. Just as the regulatory scheme of the Federal Depositor Insurance Corporation regulates the business of banking for the protection of depositors, § 3903.42 regulates the business of insurance for the protection of policyholders. We feel the risk safeguarded against by such a statute is suffi-

cient to qualify under *Pireno* for protection from federal preemption.

Although § 3903.42 transfers an insured's risk at the time of contracting, we cannot agree that this finding alone is sufficient to support a judgment for Fabe. *Pireno*, 458 U.S. at 129; Cf. *Gordon*, 688 F. Supp. at 490-91. The second *Pireno* criteria must also be met: whether the regulation at issue is an integral part of the policy relationship between insurer and insured. Unlike *National Securities*, *Royal Drug*, and *Pireno*, this case does not involve a third-party non-insurer seeking to avoid the provisions of federal law through the operation of the McCarran-Ferguson Act. Rather, it concerns a state law designed to protect the interests of insureds in their relationship with insurers by providing assurances as to the reliability and enforcement of the policies issued. See *National Securities*, 393 U.S. at 460.

The United States asserts that § 3903.42 has no impact upon the policy relationship because it applies only to insolvent insurers no longer in the "business of insurance." See *Soward*, 858 F.2d at 452. We find this argument to misunderstand the nature of an insolvent insurer. Once an insurer is placed in receivership, only the sale of new policies is suspended during liquidation; the actual adjustment of claims and the payment of existing claims continue. The continuation of these activities, central to the "business of insurance," forecloses the United States' argument. *Pireno*, 458 U.S. at 134 n.8. Accordingly, because of its direct and substantial impact upon the policyholder, we find § 3903.42 constitutes an integral part of the policy relationship between insurer and the insured, satisfying the second prong of *Pireno*.

Finally, we find that § 3903.42 satisfies the third prong of *Pireno* because the priority scheme, by its

own terms, is limited to entities within the insurance industry. Although the liquidation of an insurance company necessarily involves the claims of non-policied creditors, it is clear from the language and operation of § 3903.42 that its focus is the protection of insureds by diverting the scarce resources of the liquidated entity away from any non-insured creditors, toward policyholders. See *National Securities*, 393 U.S. at 460 (involvement of entities outside insurance industry impermissible where goal of regulation is not the protection of policyholders). The insurance liquidation priority scheme "need not be denied the § 2(b) exemption solely because" it also determines the rights of other non-policyholders. *Pireno*, 458 U.S. at 133.

Because we find Ohio Rev. Code § 3903.42 satisfies all three prongs of the *Pireno* analysis, it is exempt from federal preemption as a regulation of the "business of insurance" within the McCarran-Ferguson Act. The judgment of the district court is reversed and the case is remanded for entry of judgment in favor of the liquidation of American Druggists' Insurance Company pursuant to Ohio law.

EDGAR, District Judge, concurring:

I concur that the application of the three-part *Pireno* test to Ohio Rev. Code § 3903.42 requires that it not be superseded by the federal superpriority statute, 31 U.S.C. § 3713(a)(1)(A). I also believe that the result reached by Judge Martin is compelled for other reasons.

The states have always presided over the liquidation of insolvent companies. The states did this for many years prior to the Supreme Court's decision in *United States v. South-Eastern Underwriters Ass'n*,

322 U.S. 533 (1944). See *Motlow v. Southern Holding & Securities Corp.*, 95 F.2d 721, 725-26 (8th Cir.), cert. denied, 305 U.S. 609 (1938); *In re Peoria Life Ins. Co.*, 75 F.2d 777, 778 (7th Cir.), cert. denied, 296 U.S. 594 (1935). The states have continued to play this role. The federal Bankruptcy Code has never attempted to invade the province of the states in handling the liquidation of insurance companies.

Although Judge Martin has reached a different conclusion, I believe the purpose of the McCarran-Ferguson was to restore the law to its status prior to *South-Eastern Underwriters*. As Justice Stewart said in *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979), "There is no question that the primary purpose of the McCarran-Ferguson Act was to preserve state regulation of the activities of insurance companies, as it existed before the *South-Eastern Underwriters* case." 440 U.S. at 218 n. 18 (emphasis in original). See *Securities and Exchange Comm'n v. National Securities, Inc.*, 393 U.S. 453, 459 (1969). It may reasonably be inferred, therefore, that Congress intended that long standing, traditional state regulation of insurance company liquidations continue unmodified by federal statute after the enactment of McCarran-Ferguson. Certainly there is no language in either McCarran-Ferguson or the federal superpriority statute which indicates otherwise.

In *National Securities* the "business of insurance," which was re-subjected to state regulation by McCarran-Ferguson, was described by the Supreme Court as follows:

Congress was concerned with the type of state regulation that centers around the contract of

insurance, the transaction which *Paul v. Virginia*[, 75 U.S. 168 (1869),] held was not "commerce." The relationship between insurer and insured, the type of policy which could be issued, its *reliability*, interpretation, and *enforcement*—these were the core of the "business of insurance." Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly, are laws regulating the "business of insurance."

393 U.S. 453 at 460 (emphasis added).

The Ohio liquidation statute prefers the claims of policyholders over those asserted by the United States government under the superpriority statute. The statute is thus aimed directly at the reliability of insurance policies purchased from Ohio insurance companies and with the enforceability of those policies. Even though the payment and adjustment of claims occur after the insurance company is in the hands of a liquidator, this does not mean that the company is no longer in the "business of insurance." The Ohio statute is quintessentially a state law that relates to the regulation of the business of insurance.

JONES, Circuit Judge, dissenting. The majority correctly phrases the narrow issue presented to us for review as "whether the Ohio insurance liquidation priority statute is a state law regulating the 'business of insurance' within the meaning of the McCarran-

Ferguson Act.” Maj. op. at 3. In my view, however, the majority attaches too broad an interpretation to the phrase “the business of insurance”, and as a result incorrectly concludes that Ohio’s liquidation priority scheme is not subject to federal preemption. Such a holding fails to comport with relevant caselaw from other Courts of Appeals and the U.S. Supreme Court. I respectfully dissent.

Two other Circuits have already addressed the precise issue before us and have persuasively concluded that the liquidation of insolvent insurance companies is not “the business of insurance” within applicable Supreme Court precedent. In both *State of Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988), *cert. denied*, 109 S. Ct. 2063 (1989) and *Gordon v. U.S. Dep’t of Treasury*, 668 F. Supp. 483 (D.Md. 1987), *aff’d*, 846 F.2d 272 (4th Cir.), *cert. denied*, 109 S. Ct. 390 (1988), as in the instant case, a state’s insurance authorities, in its capacity as liquidator or receiver for an insolvent insurance company, challenged the federal government’s assertion of priority. In both these cases, directly on point with the instant case, the priority of the federal government’s claim was upheld. The majority concedes that the Fourth and Ninth Circuits have explicitly rejected Fabe’s theory, yet reaches a directly opposite result based on abstention cases of questionable relevance and pure *ipse dixit*.

The majority emphasizes the scope of the Ohio liquidation statute. However, Ohio’s ability to regulate the entire relationship between insurer and insured is not at issue. It is elementary that “[r]eorganization of insolvent insurance companies is a matter of state law and is handled through insolvency proceedings in state court.” *Gordon*, 668 F. Supp. at

487. The federal government in this case only argues its priority in Ohio’s liquidation of an Ohio insurance company, and does not seek to challenge Ohio’s overall authority to regulate.

“[I]n determining whether a particular practice is part of the ‘business of insurance’”, three factors should be considered: “*first*, whether the practice has the effect of transferring or spreading a policyholder’s risk; *second*, whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third*, whether the practice is limited to entities within the insurance industry. None of these criteria is necessarily determinative in itself[.]” *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982). The first prong of the *Pireno* test inquires whether Ohio’s liquidation priority statute transfers or spreads a policyholder’s risk. *Pireno* stated that “[t]he transfer of risk from insured to insurer is effected by means of the contract between the parties—the insurance policy—and that transfer is complete at the time that the contract is entered.” 458 U.S. at 130. It is clear that, under *Pireno*, the transfer of risk has already been effectuated at the liquidation stage; therefore, any prioritization scheme instituted by the state of Ohio to govern liquidation of insurance companies has nothing to do with the transferring or spreading of risk within the meaning of *Pireno*. See also *Soward*, 858 F.2d at 454 (“The statute’s assignment of priority to some creditors as against governmental entities does not transfer or spread policyholder risk”); *Gordon*, 846 F.2d at 273 (insurance commissioner’s arguments fail to satisfy first prong of *Pireno* test because “the risk of insurer insolvency is certainly qualitatively distinct from the risk the policyholder seeks to transfer in an insurance contract.”).

The majority envisions two kinds of risk of loss. First, the policyholder transfers a risk of loss to the insurance company at the time the initial insurance contract is signed. The later transfer of risk of loss occurs at the moment an insurance company is liquidated and Ohio's Superintendent of Insurance is appointed as liquidator. Although Ohio's liquidation priority scheme may be characterized as a transferring a risk of loss to some extent, the ordering of creditors' claims does not effectuate a transfer of risk vis-a-vis the policyholder. The position that the liquidation of an insurance company effects a transfer of risk is directly contradicted by *Pireno*: "The transfer of risk from insured to insurer . . . is complete at the time that the contract is entered." 458 U.S. at 130. The mere fact that Ohio's liquidation priority statute was enacted "for the protection of policyholders", maj. op. at 17, is irrelevant to the issue of whether the priority scheme has the effect of transferring a policyholder's risk under *Pireno*.

The second *Pireno* prong asks us to consider whether Ohio's prioritization statute is an integral part of the policy relationship between the insurer and the insured. The majority answers this inquiry in the affirmative solely because the payment of claims continues after the insurer is placed in receivership. This analysis, however, attributes to the liquidator rights which have already vested by virtue of the initial contract between the insurer and the insured. Simply because the insured's right to receive payment under the initial contract of insurance continues after the insurer is placed in receivership does not indicate to me that the statute at issue is "an integral part of the policy relationship between the [now-defunct] insurer and the insured." 458 U.S.

at 129. The policyholder's rights and responsibilities are still governed by the original contract of insurance entered into with the insured. Rather than playing an integral role in the policy relationship between insurer and insured, Ohio's priority statute instead addresses "the relationship between those left in the lurch by the expiration of the insurer." *Soward*, 858 F.2d at 454. I am persuaded by the reasoning of the district court in *Gordon*, specifically adopted by the Fourth Circuit:

[N]either the liquidation statute nor the priority statute are an "integral part" of the relationship between the insured and the insurer. The contractual liability to pay on a policy of insurance is obviously distinct from the question of who gets paid first. As with the claims adjustment process described in *Pireno*, the concern is whether a claim is paid, not why it is paid. *Pireno*, 458 U.S. at 132, 102 S. Ct. at 3010. Plaintiff contends that the priority statute does in fact determine whether a policyholder gets paid. The fallacy of plaintiff's argument is in his focus on the sufficiency of assets of the insurance company and its financial ability to pay rather than its liability for risks of loss as embodied in the contract of insurance. Whether the individual policyholder would be entitled to payment was determined when the contract was entered into; that is, when the risk was transferred, and not at the time of payment, if any.

668 F. Supp. at 491.

Under the third prong of *Pireno*, we must determine whether Ohio's priority statute "is limited to entities within the insurance industry." 458 U.S. at

129. This inquiry is easily resolved because this statute "govern[s] the rights of all creditors, not just policyholders." 668 F. Supp. at 491. "Creditors of all varieties have their claims assigned priorities by the statute, including the local, state, and federal governments." *Soward*, 858 F.2d at 454. The majority initially admits that an insurance company's liquidation encompasses non-policied creditors, but nevertheless finds for plaintiff on this issue because the funds used to pay non-policied creditors may reduce the funds available to pay policyholders. Although ensuring that valid claims of policyholders are paid is an admirable goal, it is not relevant to our inquiry under *Pireno*. Indeed, were we writing on a clean slate I would agree with the majority that the concerns of the policyholders of a liquidated insurance policy should figure prominently in our analysis.¹ However, as a lower court, we are obliged to follow the dictates of the Supreme Court and to eschew broad public policy considerations, especially in this case where constitutional questions of due process or equal protection are not presented. Accordingly, because I believe that applicable law mandates the priority of the federal claim in this liquidation proceeding, I dissent.

¹ The majority assertion that "it is clear" that the focus of Ohio's liquidation priority statute "is the protection of insureds", maj. op. at 18, is correct in the sense that Ohio's priority statute prioritizes the claims of policyholders above the claims of general creditors and claims of any federal, state, or local government. Ohio Rev. Code Ann. § 3903.42 (Baldwin 1989). However, there are two categories whose claims take priority over the claims of policyholders: (1) "[t]he costs and expenses of administration", and (2) "[d]ebts due to employees for services performed[.]" *Id.*

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

Case C-2-88-778

GEORGE FABE, SUPERINTENDENT OF INSURANCE,
PLAINTIFF

vs.

UNITED STATES DEPARTMENT OF THE TREASURY,
ET AL., DEFENDANTS

MEMORANDUM AND ORDER

[Filed Mar. 15, 1990]

On July 26, 1988, plaintiff filed the instant declaratory judgment seeking a determination as to the priority of claims of the United States in the liquidation of an insolvent Ohio insurance company. This matter is presently before the court on cross-motions for summary judgment.

STATEMENT OF FACTS

The facts as set forth in the complaint and admitted in defendants' answer are as follows: Plaintiff George Fabe is the Superintendent of Insurance for the State of Ohio. On April 30, 1986, the Court

of Common Pleas for Franklin County, Ohio issued an order finding American Druggists' Insurance Company (hereinafter "ADIC" to be insolvent. Pursuant to Ohio Revised Code Chapter 3903 the court appointed plaintiff Fabe as liquidator and directed that ADIC be liquidated.

The United States filed claims in the ADIC liquidation based primarily upon "immigration bonds, appearance bonds, and performance and payment bonds." Defendant Mitchell A. Levine, Assistant Commissioner, United States Department of the Treasury, notified plaintiff on August 28, 1986, that the claims of the United States were entitled to first priority in the ADIC liquidation by virtue of 31 U.S.C. § 3713.

Plaintiff alleges 31 U.S.C. § 3713 does not apply to a state's liquidation of an insurance company because of the McCarran-Ferguson Act, 15 U.S.C. § 1011 *et seq.* Accordingly, plaintiff argues that the claims asserted by the United States are not entitled to first priority, but are entitled only to the priority afforded under state law, specifically Ohio Rev. Code § 3904.42. Plaintiff alternatively alleges that the claims arising under the Miller Act, 40 U.S.C. § 270a-d, are not debts to the United States within the meaning of 31 U.S.C. § 3713. Defendant responds that the claims of the United States, which include the Miller Act claims, are entitled to priority in the ADIC liquidation in accordance with 31 U.S.C. § 3713.

DISCUSSION

The parties agree that there are no material facts in dispute and that the issues raised in their respective motions for summary judgment concern only questions of federal and state law.

A. *Priority of Claims of the United States*

The predominant issue in dispute concerns whether the priority to be given to the claims of the United States in the ADIC liquidation is to be determined under federal or state law. Defendant relies on the federal priority statute, 31 U.S.C. § 3713(a), which provides in pertinent part:

- (1) A claim of the United States Government shall be paid first when—
 - (A) a person indebted to the Government is insolvent and—
 - (i) the debtor without enough property to pay all debts makes a voluntary assignment of property;
 - (ii) property of the debtor, if absent, is attached; or
 - (iii) an act of bankruptcy is committed.

Plaintiff argues that 31 U.S.C. § 3713 does not control because the claims at issue are claims against the assets of an insolvent insurance company being liquidated pursuant to state insurance law. Plaintiff relies on the McCarran-Ferguson Act, 15 U.S.C. § 1012, which provides in pertinent part:

- (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several states which relate to the regulation or taxation of such business.
- (b) No Act of Congress shall be construed to invalidate, impair, or supercede any law enacted by any State for the purpose of regulating the business of insurance, or which

imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance.

Plaintiff argues that to apply 31 U.S.C. § 3713 and give the claims of the United States first priority in this instance would impair the laws of the state of Ohio enacted to govern the business of insurance. The parties agree that the state laws under which plaintiff proceeds regulate the insurance industry and that the federal priority statute would alter, and thus "invalidate, impair, or supercede" the priority scheme set forth in the state statute. The parties further agree that the federal priority statute is not an act which "specifically relates to the business of insurance." The issue then, as properly framed by the parties, is whether the Ohio statutes regulating the liquidation of insolvent insurance companies are laws regulating the "business of insurance" within the meaning of 15 U.S.C. § 1012(b).

The United States Supreme Court has provided some guidance as to the scope of the term "business of insurance." One of the seminal cases on this subject is *Securities and Exchange Commission v. National Securities, Inc.*, 393 U.S. 453 (1969), in which the Supreme Court held that a state statute aimed at protecting stockholders of insurance companies is not a regulation of the business of insurance. The court reasoned:

Congress was concerned with the type of state regulation that centers around the contract of insurance, The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement—these were the core of the "business

of insurance." Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly, are laws regulating the "business of insurance."

Id. at 460.

In *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979), the court considered whether alleged anticompetitive agreements between an insurance company and several pharmacies were exempt from the antitrust laws because they are the "business of insurance" within the meaning of § 2(b) of the McCarran-Ferguson Act (15 U.S.C. § 1012(b)).¹ The court concluded that the agreements at issue were not the business of insurance. Examining the legislative history of 15 U.S.C. § 1012, the court noted that, "References to the meaning of the 'business of insurance' in the legislative history of the McCarran-Ferguson Act strongly suggest that Congress understood the business of insurance to be the underwriting and the

¹ The Act, in addition to the language quoted *supra* page 4, further provides:

That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

spreading of risk." *Id.* at 220-21. The court also indicated that the "business of insurance" is not synonymous with the "business of insurance companies." *Id.* at 211.

The Supreme Court again examined the McCarran-Ferguson Act in the context of antitrust litigation in *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). In *Pireno* the court discussed at length the analysis set forth in *Royal Drug* and summarized that *Royal Drug* "identified three criteria relevant in determining whether a particular practice is part of the 'business of insurance'" within the meaning of § 2(b) of the Act:

first, whether the practice has the effect of transferring or spreading a policyholder's risk; *second*, whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third*, whether the practice is limited to entities within the insurance industry.

Id. at 129. The court also noted that "[n]one of these criteria is necessarily determinative in itself." *Id.*

The parties have identified only two federal cases addressing the particular question raised in the present case, that is, whether the liquidation of an insolvent insurance company constitutes the "business of insurance" as that term is used in McCarran-Ferguson Act § 2(b). In each of these cases the court rejected the position asserted by plaintiff and held that the liquidation of an insolvent insurance company, and the priority to be given to claims made therein, does not constitute the business of insurance within the meaning of 15 U.S.C. § 1012(b). *State of Idaho ex rel. Soward v. United States*, 858 F.2d 445

(9th Cir. 1988), *cert. denied*, 109 S. Ct. 2063 (1989); *Gordon v. United States Dept. of the Treasury*, 668 F. Supp. 433 (D. Md. 1987), *affirmed*, 846 F.2d 272 (4th Cir.), *cert. denied*, 109 S. Ct. 390 (1988).² Plaintiff asserts that these two cases wrongly applied the Supreme Court precedents as to what constitutes the business of insurance.

The state regulation at issue in this case, Ohio Rev. Code Chapter 3903, provides a comprehensive scheme for the supervision, rehabilitation, and/or liquidation of insurance companies. The Superin-

² See also *Langdeau v. United States*, 363 S.W. 2d 327, 331 (Tex. Civ. App. 1962) (holding that the state's priority statute did not regulate the business of insurance and therefore the federal government's tax claims were entitled to first priority).

This result also finds some support in *Royal Drug* itself:

Many aspects of insurance companies are regulated by state law, but are not the "business of insurance." Similarly, the enabling statutes in existence at the time the Act was enacted typically regulated such diverse aspects of the plans as the composition of their boards of directors, when their books and records could be inspected, how they could invest their funds, *when they could liquidate* or merge, as well as how they could purchase goods and services by entering into provider agreements.

Provider agreements are no more the "business of insurance" because they were regulated by state law at the time of the McCarran-Ferguson Act than are these other facets of the plans which were similarly regulated. If Congress had exempted the "business of insurance companies," then these aspects of the plans which are not themselves insurance as that term is commonly understood would nevertheless be arguably exempt. But since Congress explicitly rejected this approach, they are not within the exemption even though they are the subject of state regulation.

Id. at 230 n.38 (emphasis added).

tendent of Insurance may file a complaint seeking an order to liquidate an insurer for one of a number of reasons, Ohio Rev. Code § 3903.17, and if the Court of Common Pleas issues an order to liquidate the superintendent is appointed as liquidator and is directed to liquidate the company. Ohio Rev. Code § 3903.18(A). Within such liquidation Ohio Rev. Code § 3903.43 establishes the priorities for payment of claims. Under section 3903.43 administrative costs are given first priority, and wage claims of employees are given second priority. Third priority includes "[a]ll claims under policies for losses incurred." The claims of the federal government are fifth in priority, behind the claims of general creditors. The issue presented is whether the liquidation regulations, and particularly the above priority scheme, constitute the "business of insurance."

There appears to be some question raised as to whether the *Royal Drug-Pireno* three-part test should be applied at all to activity which falls outside the antitrust exemption context. Plaintiff and defendant each argue in their respective motions as if that test is applicable in this case. However, plaintiff also relies upon a recent law review article in which the author argues that the *Royal Drug-Pireno* test is not applicable in the situation presented because those cases were limited to the McCarran-Ferguson Act's antitrust exemption which is not implicated in a dispute over priority of claims. Howard, *Uncle Sam Versus the Insurance Commissioners: A Multi-level Approach to Defining the "Business of Insurance" Under the McCarran-Ferguson Act*, 25 Willamette L. Rev. 1, 79 (1989). This Court is not persuaded that the *Royal Drug-Pireno* definition of "business of insurance" is limited to the use of that term in the antitrust exemption, as the Court sees no convincing

reason why the term "business of insurance" should be given different interpretations when used more than once in the same statute. Neither *Royal Drug* nor *Pireno* suggest any intention to limit the three-part test to strictly antitrust exemption cases. *Accord Gordon v. United States Dep't of the Treasury*, 846 F.2d 272, 273 (4th Cir. 1988) (finding that the Supreme Court's discussions of the definition of "business of insurance" in *Royal Drug* and *Pireno* "are not, expressly or by logical implication, limited to the antitrust context").³ Indeed, the Supreme Court has subsequently used the test to define the insurance business in other contexts. *See Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 742-44 (1985) (using *Pireno* test in defining the "regulation of insurance" as that term is used in the ERISA insurance savings clause, 29 U.S.C. § 1144 (b)(2)(A)); *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 50-51 (1987) (same). Thus this Court rejects a "multi-definitional approach" to the term "business of insurance" and holds that *Royal Drug* and *Pireno* set forth the appropriate test for determining the scope of that term in 15 U.S.C. § 1012 regardless of the context in which such determination is called for.⁴

³ While Howard cites *Hahn v. Oregon Physicians Serv.*, 689 F.2d 840, 842 (9th Cir. 1982), *cert. denied*, 462 U.S. 1133 (1983), as "suggesting" that *Royal Drug* and *Pireno* are limited to the antitrust exemption, this Court does not read *Hahn's* discussion of *Royal Drug* and *Pireno* as a limitation on those cases.

⁴ At least one other commentator has also suggested that the term "business of insurance" has different meanings within 15 U.S.C. § 1012(b). *See Note, The Definition of "Business of Insurance" Under the McCarran-Ferguson Act*

Pireno first directs the Court's attention to the question "whether the practice has the effect of transferring or spreading a policyholder's risk." *Pireno*, 458 U.S. at 129. The *Gordon* court, analyzing the Maryland priority statute similar to Ohio Rev. Code § 3903.43, rejected the argument that liquidation of insolvent insurance companies does effect the transferring or spreading of a policyholder's risk. *Gordon*, 668 F. Supp. at 489-91. With regard to when that risk is transferred the court relied on the clear statement in *Pireno* that, "The transfer of risk from insured to insurer is effected by means of the contract between the parties—the insurance policy—and that transfer is complete at the time that the contract is entered." *Pireno*, 458 U.S. at 130.⁵ The *Gordon* court noted that "[t]he risk that an insurance company will become insolvent . . . is not the kind of risk transfer emphasized in *Pireno* and *Royal Drug*." *Gordon*, 668

After *Royal Drug*, 80 Colum. L. Rev. 1475, 1484 (1980). However, neither Howard nor the author of this Note cite any authority for such a proposition other than a general reference to legislative intent. In this Court's view, if Congress had intended that "business of insurance" be given multiple definitions it could have used different terms or otherwise so stated.

⁵ On this point, this Court rejects plaintiff's assertion that "the risk is not spread in reality until insurer assets are used to pay a covered loss." The language used by the Supreme Court is clear and suggests no distinction between a "theoretical" spreading of risk and a "real" spreading of risk. In fact, the Supreme Court expressly rejected the very same argument in *Pireno*, stating that the premise that the transfer of risk takes place "when the insured's claim is settled" is "contrary to the fundamental principle of insurance that the insurance policy defines the scope of risk assumed by the insurer from the insured." *Id.* at 131.

F. Supp. at 490. This Court agrees that the liquidation process, with its prioritization and payment of claims, does not involve the transfer of spreading of policyholder risk as explained in *Pireno* and *Royal Drug*. The first of the three criteria identified in *Pireno* would therefore suggest that the liquidation of insolvent insurance companies does not constitute the business of insurance. As this Court does not believe that this factor alone is determinative, *Pireno*, 458 U.S. at 129, the Court will consider the remaining elements of the test as well.

The Court is unpersuaded by plaintiff's arguments on the second prong of the *Pireno* test, that is, "whether the practice is an integral party of the policy relationship between the insurer and the insured." *Pireno*, 458 U.S. at 129. On this point the *Gordon* court noted that, "The contractual liability pay on a policy of insurance is obviously distinct from the question of who gets paid first." *Gordon*, 668 F. Supp. at 491. The court further stated: "Whether the individual policyholder would be entitled to payment was determined when the contract was entered into; that is, when the risk was transferred, and at the time of payment, if any." *Id.* This Court is not persuaded by plaintiff's argument that such reasoning is "preposterous."

Finally, the Court believes that the liquidation process is not "limited to entities within the insurance industry." *Pireno*, 458 U.S. at 129. The state priority statute obviously effects the claims of various types of creditors. Moreover, as noted in *Gordon*, "Insolvency and priority statutes . . . are not peculiar to the insurance industry. The appropriate focus of the 'business of insurance' analysis is the nature of the activity itself, not the type of business that is conduct-

ing it." *Gordon*, 668 F. Supp. at 491 (citing *Perry v. Fidelity Union Life Ins. Co.*, 606 F.2d 468, 470 (5th Cir. 1979), *cert. denied*, 446 U.S. 987 (1980)).

The *Soward* court took a different approach to the conclusion that insurance company liquidation is not the business of insurance. Applying *National Securities*, 393 U.S. 453, the court recognized that the liquidation statute "deals with insurance companies that no longer are in the business of insurance." *Soward*, 858 F.2d at 452. The state priority statute therefore governs not the insurer-insured relationship but rather the relationship between debtor and creditor. *Id.* The court found it unnecessary to consider the three-part test of *Royal Drug* and *Pireno* for two reasons: (1) because of the insurance company's insolvency and liquidation "there is no activity of an insurance company to be assessed"; and (2) the state priority statute does not implicate policyholders as such either directly or indirectly. *Id.* at 453.⁶ However, the court also noted that even under the *Royal Drug-Pireno* test the state priority statute does not regulate the business of insurance. *Id.* at 453-54.

There is some support, however, for plaintiff's position. In *Levy v. Lewis*, 635 F.2d 960 (2d Cir. 1980), the Second Circuit considered the application of the abstention doctrine in the context of an ERISA action filed in federal court against the liquidator of an insurance company by former employees of the company. Citing the McCarran-Ferguson Act, the court expressed its view that "the administrative and ju-

⁶ The *Soward* court described *Royal Drug* and *Pireno* as "refinements of the seminal analysis of *National Securities* tailored to address activities of insurance companies that would implicate the antitrust laws in the absence of the McCarran-Ferguson Act." *Id.* at 453.

dicial scheme erected by New York to regulate insurance companies, including that part enabling the institution and implementation of liquidation proceedings, operates pursuant to an express federal policy of noninterference in insurance matters." *Id.* at 963. Accordingly, the court concluded that the federal courts should abstain in cases raising ERISA claims which such claims can be resolved in the state liquidation proceeding. *Id.* at 967. Other abstention cases have similarly held that a federal court should stay its hand when presented with a claim to the assets of an insolvent insurance company where such claim can be presented to and resolved by a state court presiding over the liquidation of that company. See, e.g., *Lac D'Amiante du Quebec, Ltee. v. American Home Assurance Co.*, 864 F.2d 1033 (3d Cir. 1988); *Grimes v. Crown Life Ins. Co.*, 857 F.2d 699 (10th Cir. 1988), *cert. denied*, 109 S.Ct. 1568 (1989); *Corcoran v. Ardra Ins. Co., Ltd.*, 842 F.2d 31 (2d Cir. 1988).

Although the principles underlying the abstention doctrine are clearly inapposite in the present case, the Court does read the above abstention cases as based at least in part on a theory that state regulation of insurance company insolvency and rehabilitation constitutes regulation of the business of insurance within the meaning of the McCarran-Ferguson Act. In the Court's view, as noted earlier, the question of whether liquidation of insolvent insurance companies constitutes the business of insurance should not depend on the context in which that question is asked. Cf. *Lac D'Amiante du Quebec*, 864 F.2d at 1039 n.8 (finding that reliance upon the McCarran-Ferguson Act in the abstention context "does not require us to discern whether state regulation of insurer insolvencies con-

stitutes regulation of the business of insurance for other purposes"). Nevertheless, the Court is persuaded that *Soward* and *Gordon* reached the correct result of the central issue presented. The abstention cases cited above did not specifically analyze the scope of the term "business of insurance" under the criteria set forth in *Royal Drug* and *Pireon*. See *Gordon*, 668 F. Supp. at 489 n.8; but see *United Services Auto. Ass'n v. Muir*, 792 F.2d 356, 365 (3d Cir. 1986) (citing the *Pireno* test and noting that the state regulations at issue in *Levy* "concerned both the future coverage of policyholders and their relationship with a defunct insurer, and so were authorized under McCarran-Ferguson"), cert. denied, 479 U.S. 1031 (1987). The Supreme Court has established the test for determining what constitutes the "business of insurance," and the only cases applying that test to insurance company liquidation have concluded that such activity does *not* constitute the business of insurance.

In summary, in the absence of controlling authority to the contrary, the Court is persuaded by the analysis set forth in *Gordon*, and concurs in the result reached in both *Gordon* and *Soward*. From plaintiff's perspective there may indeed be strong policy arguments behind allowing states complete control in prioritizing claims to the assets of an insolvent insurer under liquidation. However, such control would work at the expense of the policy underlying the federal priority statute, which is the securing of an adequate revenue to sustain the public burdens and discharge the public debts. See *United States v. Moore*, 423 U.S. 77, 80-83 (1975). In any event, as explained above, the United States Supreme Court appears to have adopted a somewhat limited definition

of the "business of insurance" as that term is used in section 2(b) of the McCarran-Ferguson Act. Under the Supreme Court's analysis the scope of the term "business of insurance" is limited to those activities directly or indirectly affecting the risk transfer indicative of the insured-insurer relationship. As correctly determined in both *Gordon* and *Soward*, the liquidation of insolvent insurance companies and the concomitant prioritization of claims do not affect the transfer or spreading of risk. Accordingly, this Court concludes that Ohio Rev. Code § 3903.42 is not a state law regulating the "business of insurance" within the meaning of 15 U.S.C. § 1012(b).

The Court therefore concludes that the federal priority statute, 31 U.S.C. § 3713(a), is not limited in its application in this case by 15 U.S.C. § 1012(b). Under 31 U.S.C. § 3713(a) the claims of the United States are entitled to first priority in the liquidation of ADIC. To the extent Ohio Rev. Code § 3903.42 provides a lesser priority it is inconsistent with federal law. Pursuant to Article VI clause 2 of the United States Constitution, 31 U.S.C. § 3713 controls notwithstanding the contrary Ohio Rev. Code § 3903.42. Having reached this conclusion, the court need not address the arguments of the parties as to the priority given to the claims of the federal government under Ohio Rev. Code § 3903.42, or plaintiff's argument as to why that issue should not be addressed by this Court.

B. *Priority of Claims Under the Miller Act.*

The second issue raised by the parties concerns whether certain claims asserted by defendants in the ADIC liquidation are "claim[s] of the United States Government" within the meaning of 31 U.S.C. § 3713(a). Plaintiff herein argues that certain of the

claims asserted by defendants are claims on Miller Act payment bond which are not claims of the United States. Defendants respond that the purposes of the Miller Act would be defeated if the claims asserted pursuant to that Act are not given the protection afforded in the federal priority statute. Although some of the claims at issue in *Gordon* were claims of materialmen, suppliers and subcontractors under Miller Act payment bonds, the parties therein had resolved their dispute as to those claims and thus the court did not specifically address whether such claims were debts owed to the United States under 31 U.S.C. § 3713(a). *Gordon*, 668 F. Supp. at 485 n.1.

To resolve this issue, as plaintiff correctly notes, this Court need look no further than the plain language of the Miller Act. The Act, 40 U.S.C. § 270b, provides in pertinent part:

- (a) Every person who has furnished labor or material in the prosecution of the work provided for in such contract, in respect of which a payment bond is furnished under sections 270a to 270d of this title and who has not been paid in full therefor before the expiration of a period of ninety days after the day on which the last of the labor was done or performed by him or material was furnished or supplied by him for which such claim is made, shall have the right to sue on such payment bond for the amount, or the balance thereby unpaid at the time institution of such suit and to prosecute said action to final execution and judgment for the sum or sums justly due him. . . .
- (b) Every suit instituted under this section shall be brought in the name of the United States

for the use of the person suing, The United States shall not be liable for the payment of any costs or expenses of any such suit.

From the language of 40 U.S.C. § 270b it is clear that it provides to certain laborers and materialmen a cause of action on payment bonds required by the Miller Act. While the suit is brought "in the name of the United States for the use of the person suing," it is clear that the cause of action belongs to the laborer, materialman, or subcontractor and not to the nominal party the United States. See *Blanchard v. Terry & Wright, Inc.*, 331 F.2d 467, 469-70 (6th Cir.) (holding that the interest of the United States in such an action is "merely nominal" and that the "use plaintiffs," the laborers, materialmen, or subcontractors, are "the real parties in interest"), *cert. denied*, 379 U.S. 831 (1964). In this regard, of course, a "payment" bond must be distinguished from a "performance" bond. Pursuant to 40 U.S.C. § 270a(a), a performance bond is required "for the protection of the United States," while a payment bond is to provide "protection of all persons supplying labor and material." See *United States for the Use and Benefit of Bryant Electric Co. v. Aetna Casualty & Surety Co.*, 297 F.2d 665, 668 (2d Cir. 1962) ("The government, being safeguarded by the performance bond, had no direct interest in the payment bond."). Notwithstanding the single reference on page 31 of defendants' memorandum to "performance bonds," the Court understands that the disputed issue is the priority to be afforded Miller Act payment bond claimants.

Defendant argues that "the federal priority must apply to Miller Act payment bond claimants in order

to afford the Miller Act its proper role in the federal body of law." It is recognized that the purpose behind the Miller Act is to afford protection to person supplying labor and materials on federal construction projects. See *United States for the Benefit of Sherman v. Carter*, 353 U.S. 210, 216 (1957). However, defendants have stated no convincing reason why that policy requires treating Miller Act claims of laborers and materialmen as claims of the United States for purposes of the federal priority statute. It may well advance the policies behind the Miller Act to elevate the priority of payment bond claimants. However, as plaintiff correctly states, that is a matter for Congress and not for this Court. Therefore, this Court concludes that claims of laborers, materialmen, and subcontractors under Miller Act payment bonds are not debts owed to the United States government under the federal priority statute. Accord, *Florida Bank & Trust Co. v. Union Indemnity Co.*, 55 F.2d 640, 641 (4th Cir.), cert. denied, 287 U.S. 600 (1932).

CONCLUSION

The Court concludes that the liquidation of an insolvent insurance company, and its attendant prioritization of claims, does not constitute the "business of insurance" within the meaning of 15 U.S.C. § 1012(b) as that term has been defined by the United States Supreme Court. Thus, the federal priority statute, 31 U.S.C. § 3713, does not "invalidate, impair, or supersede" a state law regulating the business of insurance notwithstanding that it affords a higher priority to claims of the federal government than that provided in Ohio Rev. Code § 3903.42. Accordingly, the claims of the United

States in the ADIC liquidation are entitled to first priority. However, such claims do not include the claims of laborers, materialmen, and subcontractors suing on payment bonds under the Miller Act. Such claims belong to the laborers, materialmen, or subcontractors themselves and are not claims of the federal government within the meaning of 31 U.S.C. § 3713. Accordingly, the Miller Act payment bond claims are entitled to whatever priority is afforded them under Ohio Rev. Code § 3903.42.

For the foregoing reasons, the summary judgment motions of plaintiff and defendant are hereby each GRANTED IN PART AND DENIED IN PART. The Court hereby enters judgment as follows: (1) The claims of the United States are entitled to first priority in the ADIC liquidation, pursuant to 31 U.S.C. § 3713, notwithstanding the contrary provision of Ohio Rev. Code § 3903.42; and (2) the claims of laborers, materialmen, and subcontractors under Miller Act payment bonds are not claims of the United States and thus are entitled only to the priority afforded them under Ohio Rev. Code § 3903.42.

IT IS SO ORDERED.

/s/ John D. Holschuh
JOHN D. HOLSCHUH, Judge
United States District Court

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APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 90-3364

GEORGE FABE, Superintendent of Insurance,
State of Ohio, PLAINTIFF-APPELLANT

v.

UNITED STATES DEPARTMENT OF THE TREASURY;
MITCHELL A. LEVINE, Assistant Commissioner,
DEFENDANTS-APPELLEES

Before: Martin and Jones, Circuit Judges;
Edgar, District Judge

JUDGMENT

[Filed Jul. 17, 1991]

ON APPEAL from the United States District
Court for the Southern District of Ohio at Columbus.

THIS CAUSE was heard on the record from the
district court and was argued by counsel.

ON CONSIDERATION WHEREOF, it is ordered
that the judgment of the district court is reversed
and the case is remanded for entry of judgment in

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favor of the liquidation of American Druggists' In-
surance Company pursuant to Ohio law.

ENTERED BY ORDER OF THE COURT

/s/ Leonard Green
LEONARD GREEN
Clerk

A True Copy.
Attest:

/s/ [Illegible]
Deputy Clerk

Issued as Mandate: December 2, 1991

COSTS: None

Filing Fee	\$
Printing	\$
Total	\$

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 90-3364

GEORGE FABE, SUPERINTENDENT OF INSURANCE,
STATE OF OHIO, PLAINTIFF-APPELLANT

v.

UNITED STATES DEPARTMENT OF THE TREASURY;
MITCHELL A. LEVINE, ASSISTANT COMMISSIONER,
DEFENDANTS-APPELLEESBEFORE: MARTIN and JONES, Circuit Judge;
and EDGAR,* United States District
Judge.

ORDER

[Filed Nov. 21, 1991]

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion

* Hon. R. Allan Edgar sitting by designation from the Eastern District of Tennessee.

for rehearing en banc, the petition for rehearing has been referred to the original hearing panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

ENTERED BY ORDER OF THE COURT

/s/ Leonard Green
LEONARD GREEN
Clerk